No. 1490

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

FRANK WATERHOUSE & CO., Inc.,
Appellant,

vs.

GRENVILLE M. DODGE and FRANK WATERHOUSE,
Appellees.

In Equity

APPEAL FROM THE UNITED STATES CIRCUIT COURT FOR THE WESTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

Reply Brief for Appellant

W. H. BOGLE,
CHARLES P. SPOONER,
Solicitors for Appellant.

377 Colman Block,
SEATTLE, WASHINGTON.

The Ivy Press, Second and Cherry, Seattle

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

FRANK WATERHOUSE & CO., Inc.,
Appellant,

vs.

GRENVILLE M. DODGE and FRANK WATERHOUSE,
Appellees.

In Equity

APPEAL FROM THE UNITED STATES CIRCUIT COURT FOR THE WESTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

Reply Brief for Appellant

W. H. BOGLE,
CHARLES P. SPOONER,
Solicitors for Appellant.

377 Colman Block,
SEATTLE, WASHINGTON.

In the United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

FRANK WATERHOUSE & CO., Inc.,
Appellant,

vs.

GRENVILLE M. DODGE and FRANK WATERHOUSE,
Appellees.

In Equity

APPEAL FROM THE UNITED STATES CIRCUIT COURT FOR THE WESTERN DISTRICT OF WASHINGTON NORTHERN DIVISION

Reply Brief for Appellant

I.

It is obvious that any decree rendered in this case in favor of the appellee involves primarily an adjudication by the court that the North Alaska Steamship Company is indebted to the appellee in the amount so ascertained and decreed by the court. It seems fundamental that no such adjudication can be had in the absence of that company. Mr. Pusey in his testimony admits that the indebtedness of the North Alaska Steamship Company to the appellee was considerably less than $10,000, and says that Smith consented to add some $1,500 to the claim, making

it up to $10,000, in order to cover the expenses that complainant had been put to in endeavoring to secure his claim, including traveling expenses and attorney's fee of Pusey (Record, pp. 482, 504). The North Alaska Steamship Company is not shown to have either authorized Smith as its president to enter into such an agreement with Pusey, nor to have ratified his action after it was done. Whether the note executed by Smith to Waterhouse & Company, as trustee for Dodge, for $10,000 was a corporate act, and binding on the North Alaska Steamship Company, is a question which must primarily be settled between that company and the appellee.

In *Saloy vs. Bloch,* 136 U. S. 338, the facts were as follows: Saloy, under the laws of Louisiana, had a landlord's lien on the agricultural crops grown by his tenants, the Dragons, for the agreed rental. Bloch was a merchant advancing supplies to the Dragons. Saloy waived in writing his lien upon these crops in favor of Bloch to the extent of any supplies that Bloch might make to the tenants, and the tenants thereupon gave Bloch a lien upon the crops for supplies. Notwithstanding this waiver by Saloy, he appropriated the tenants' crops and converted them to his own use. Bloch brought suit against Saloy to recover the amount of his supplies on the above statement of facts. The court in disposing of the case said:

"But his claim against Saloy is an equitable one, and in the United States court can only be pursued on the equity side on a bill for an account * * * * * * ;

and in such suit an inquiry would be had as to the amount of Bloch's claim against the Dragons, and they would be necessary parties. The debt for which the plaintiff sues Saloy is their debt, and yet they are not cited and no judgment has been obtained against them."

In *Swan Land & Cattle Company vs. Frank,* the corporation had distributed its corporate funds among its stockholders and ceased or suspended business. A creditor of the corporation brought suit against some of the stockholders to reach and subject the corporate assets so received by them to the payment and satisfaction of his claim. The Supreme Court held that the corporation was an indispensable party, saying:

"The complainant's right to follow the corporate funds in the hands of the defendants depends upon its having a valid claim for damages against the vendor corporation. That demand is not only legal in character, but can be settled and determined by some appropriate proceeding to which the corporations against which it is made are parties and have an opportunity to be heard. Stockholders cannot be required to represent their corporations in litigation involving such questions and issues. The corporations themselves are indispensable parties to a deal which affects corporate rights or liabilities. Thus in *Deerfield vs. Nins,* 110 Mass. 115, it was held that the corporation was a necessary party in a bill by a creditor of the corporation against its officers and stockholders who had divided its assets among themselves. So, in *Gaylords vs. Kelshaw,* 1 Wall. 81, it was held by this court that in a bill to set aside a conveyance as made without consideration and in fraud of creditors, the alleged fraudulent grantor is a necessary defendant, because it was his debts that were sought to be collected, and his fraudulent conduct that required investigation."

Swan Land and Cattle Company vs. Frank, 148 U. S. 603, 610.

That case also answers the suggestion in appellant's brief to the effect that the North Alaska Steamship Company was no longer engaged in business, and therefore not a necessary party. So long as the corporation had not been dissolved, it was a necessary party to any action which sought to collect a debt owing by it. The case of *Gaylord vs. Kelshaw*, 1 Wall. 81, seems to be peculiarly in point. There the debtor, who was grantor, had by his fraudulent conveyance, divested himself of all interest in the property. The suit was an action to condemn the property for the payment of his debt; the only necessity for his presence in the case was the fact that it was his debt which the creditor was seeking to collect. The conveyance, although fraudulent as to creditors, was good between the grantor and the grantee and operated to divest all title and interest of the grantor in the property. He was held to be a necessary defendant because the court would not undertake to adjudicate the amount of his indebtedness until he was brought into the record.

In the case at bar, the court below not only adjudicated an indebtedness of the North Alaska Steamship Company, but held that company to be bound by the action of Smith in adding $1,500 to the previous indebtedness, and in executing a promissory note for the amount thus increased, and providing for payment within sixty days, and adding a clause carrying an attorney's fee in case of non-payment, and entered a judgment against the

appellant for this full amount. Even conceding that the North Alaska Steamship Company was indebted to the complainant in the sum of $8,500 balance on his loans, there is no corporate action which obligates that company in any way for the traveling expenses or attorney's fees of Mr. Pusey, which were lumped at $1,500 by him and Smith, and no action of that company which authorized Smith to execute the company's note for the amount thus increased, changing the terms of payment theretofore existing between complainant and the company, and adding the penalty of attorney's fee in case of default. It seems clear that that company must be brought into the record as a party to the proceeding before the court can adjudicate that the company really owed this $10,000 to the complainant, or was bound by the terms of the promissory note signed by Smith for the company.

We think the same result is reached from another point of view. Waterhouse & Company had never parted with the title to the vessel. The Steamship Company had a right to acquire the title to the vessel only on condition that it complied with the terms of the contract of purchase. Now, when it failed to comply with those terms, after receiving formal written notice from Waterhouse in New York that the contract would be cancelled and its rights thereunder forfeited unless it did so comply, and Waterhouse & Company did declare a forfeiture of the contract, any equity of the Steamship Company in the

vessel was thereby extinguished. If the Steamship Company had by any act on its part created a lien upon the property of Waterhouse during the time it had this right of purchase, and Waterhouse was thereafter compelled to pay the debt so incurred in order to clear up the lien on his own property, he would manifestly have a right of action over against the steamship company to recover from it the amount so paid. The steamship company was a necessary party to this proceeding therefore in order that it might be heard upon the question whether any act of that company had created a lien upon the vessel, and, second, that it might be heard upon the question of the amount of the indebtedness so incurred by it, and for which Waterhouse would have a right of action over against it.

It is claimed by the appellee that the release and receipts exchanged between Waterhouse & Company and the North Alaska Steamship Company had the effect of releasing the steamship company from any such contingent liability. We think that no such effect can be given to the release. It is clearly shown by the testimony that the receipts and release exchanged between Waterhouse & Company and the North Alaska Steamship Company related to the obligations or liabilities then asserted each against the other. Waterhouse released the steamship company from its obligation to pay the balance of the purchase money on the steamer. The steamship company released him from any obligation to return

any of the payments previously received by him from that company. They were dealing with existing liabilities. While it is true that a receipt or release is a written document, it is to be construed in the light of the facts as they existed at the time it was executed. A release given in July, 1904, will not be construed as a release of an obligation of Waterhouse & Company against the North Alaska Steamship Company which did not come into existence until the entering of a decree in this case and the payment thereof by Waterhouse.

It has been argued by appellee in his brief that the Dodge debt was one of the debts which Waterhouse & Company agreed to pay, and which was represented by the $30,000 outstanding against the vessel. This is such a manifest misrepresentation of the testimony that it does not seem to call for any special reply. The testimony with respect to the execution of these receipts is found on page 279 of the record, and is as follows:

"After the receipt of this notification from Mr. McKee, I took the matter up with him, and after some considerable discussion, he agreed that he would recommend to his company not to assert any claim for return of the moneys that they had paid, nor to engage in any litigation about it, provided full receipts were exchanged between Frank Waterhouse & Company and the North Alaska Steamship Company, so that Waterhouse could not assert any further claim against the company and the company could not assert any further claim against Frank Waterhouse & Company. He afterward and during the same day furnished me with a copy of the resolution of the board of directors under date of July 9th,

a copy of which is filed with Mr. Waterhouse's deposition and marked as defendant's Exhibit "J-3." Thereupon receipts in full were passed between Frank Waterhouse & Company and the North Alaska Steamship Company each releasing the other from any further claims. I should have stated that in this arrangement with Mr. McKee it was stipulated that Frank Waterhouse & Company should not assert any claims to the freights that were payable in Nome on the cargo carried up on the "Garonne," this being the freights that had been transferred by Mr. Smith to Mr. Pusey."

Also "During the time of these negotiations at New York Mr. Waterhouse requested his office in Seattle to wire him what amount of outstanding bills against the North Alaska Steamship Company for material, supplies, labor, etc., had been up to that date turned into the office, and which remained unpaid. He received a telegram from his office under date of July 7th furnishing that information, and which is complainant's Exhibit No. 11 in this case." (Transcript 280-81.)

These dealings had nothing to do with the Dodge claim, and the lien debts there referred to were debts for material, supplies and labor incurred by the North Alaska Steamship Company on the vessel, and which would be maritime liens.

We most respectfully insist that the North Alaska Steamship Company was an indispensable party to this proceeding.

II.

We insist that the complainant never at any time had any lien upon the ship "Garonne." The appellee places his entire contention upon the trust agreement entered into between Waterhouse & Company and Dodge's agent on June 2, 1904, and invokes the doctrine that equity considers that done which ought to have been done. His position is thus stated on page 40 of the brief:

"It is a well established maxim of equity that equity considers that done which ought to have been done, and although this mortgage was not in fact finally executed by the officers of the North Alaska Steamship Company, other than Smith, it was nevertheless a mortgage to all intents and purposes. In other words, it is an equitable mortgage."

The fallacy in the whole argument consists in the fact that this trust agreement was entered into between Waterhouse & Company, a creditor, and Dodge, a creditor; the North Alaska Steamship Company, the debtor, was not a party to it and refused to sanction it. That two creditors cannot create an equitable mortgage upon the assets of a debtor, without the debtor's consent, is too plain for argument. Even if Waterhouse & Company had specifically agreed with Dodge to hold the legal title to this vessel as security for Dodge's debt, the agreement would not have constituted even an equitable mortgage or lien without the assent of the debtor. As a matter of fact, as is plainly expressed in the face of the trust agreement, Waterhouse did not agree to hold the legal

title he then had as security for Dodge's debt, but agreed to take a mortgage from the debtor, the North Alaska Steamship Company, securing both his own and Dodge's debt. This undertaking on the part of Waterhouse was not consummated, however, because the North Alaska Steamship Company refused to execute the mortgage. Appellee's counsel have searched this record in vain in the attempt to find any act upon the part of the North Alaska Steamship Company which can be construed as creating a lien upon this vessel in favor of Dodge. There is some testimony on the part of Mr. Pusey to the effect that at the time the debt was created there had been some agreement on the part of the company to give Dodge a mortgage as soon as the company should acquire title to the vessel. The facts with respect to that agreement have not been developed for the reason that the complainant did not plead any such agreement, and it was therefore immaterial. The rights set up in the complaint and the rights asserted by appellee in his brief are based entirely upon the arrangement made on the 2nd of June, 1904. Unless some act or agreement upon the part of the North Alaska Steamship Company can be cited which act or agreement constituted a mortgage or lien upon this vessel, in favor of Dodge, then we respectfully submit that this action cannot be maintained.

But even if the North Alaska Steamship Company had been a party to this trust agreement and had spe-

cifically agreed to execute the mortgage, we think it would not change the result in this case. As we have pointed out in our original brief, there was an indebtedness of something like $30,000 for labor, material and supplies which were maritime liens upon the vessel and paramount to even the claim of Waterhouse & Company. It is true Waterhouse & Company were not personally liable therefor, but the vessel was liable. It is shown beyond cavil by the testimony that Smith agreed that these debts should be paid promptly by his company, so that the mortgage would be a first lien upon the vessel. This is shown by the testimony introduced on behalf of the defendants below, and by the letter written by Waterhouse & Company to the Occidental Securities Company at the time the documents were forwarded to the Chase National Bank (Transcript, pp. 219, 265), and is not disputed by Mr. Pusey or any other witness on behalf of the complainant. Mr. Pusey's testimony with respect to these outstanding claims is neither full nor frank. His testimony (p. 50 Transcript) taken after the testimony on behalf of the defendants was taken, seems to convey the impression that nothing special was said with respect to any outstanding bills, and that he did not understand that there were any outstanding bills "in excess of freight and passenger money." He knew, however, that approximately $18,000 of the receipts from the freight and passenger money had been paid over to Waterhouse and cred-

ited on the purchase money on the vessel, thereby reducing the balance from something over $55,000 to $37,641; and as it is an admitted fact, that there were large outstanding unpaid bills, which would be liens ahead of the mortgage contemplated at that time, and as Pusey and Smith were intimate friends of long standing, it is incredible that Smith concealed from him the fact of the existence of these outstanding claims. In fact, his own testimony shows that he did know there were outstanding claims, and he could very truthfully say that he did not know they were in excess of the freight and passenger receipts; but he was careful not to say that he did not know they were in excess of the freight and passenger receipts after the $18,000 of these receipts had been applied to the purchase price of the vessel. It is shown by the testimony for the defendants that at the time Smith and Pusey were in conference with Waterhouse, the only information then obtainable was that these outstanding bills would aggregate between $13,000 and $15,000.

Pusey does say that no one stated in his presence that Smith or his New York company or associates would advance money to pay off these supply and repair bills. In this statement his testimony is in conflict with that of the other two witnesses for the defendant who were present at that conference. Smith, who was the particular friend of the complainant, has not been examined in the case. It is reasonable to suppose that on account of the

relations existing between him and the complainant, and their residence in New York City, that his testimony would have been taken by complainant if it would have supported Pusey's testimony on this point. The testimony of the defendant's witnesses upon this proposition is also corroborated by the letter written at the same time to the Occidental Securities Company, and by the inherent probabilities. Waterhouse had a contract under which he had a right to declare a forfeiture against the purchaser; the purchaser had deliberately breached that contract by incurring these outstanding bills against the ship. The record shows that Waterhouse had for months persistently demanded the payment of these bills by the North Alaska Steamship Company, and up to as late as May 26th, less than a week before this conference, had threatened to cancel the contract unless these outstanding bills were paid. It is scarcely credible, therefore, that he would suddenly change his whole position, waive his contract and his rights under it and agree to accept a mortgage upon the vessel with prior liens existing thereon for very large sums which nobody agreed to pay off. We think, therefore, we are within the record in saying that one of the essential conditions of Waterhouse's consent to waive his contract and accept the mortgage was that these debts should be paid off by the North Alaska Steamship Company promptly so that his mortgage would be a first lien on the vessel. This, as we have stated, was

never done. Therefore we say that even if the North Alaska Steamship Company had on June 2nd approved Smith's verbal agreement to execute a mortgage, the equitable rule converting that agreement into an equitable mortgage would not be applicable for the reason that the condition upon which Waterhouse & Company agreed to waive their contract and accept a mortgage, to-wit, the payment of the outstanding maritime lien debts, was not complied with. To compel them to waive their contract rights and accept the mortgage subject to these maritime liens, would be inequitable and unjust, and would be the making of a contract by the court which Waterhouse & Company had refused to make.

The appellee in his brief charges King and Waterhouse with combination and conspiracy to defraud the appellee. He refers to Mead as a man sent out by King to investigate the status of the North Alaska Steamship Company (Transcript, p. 7).

The appellant of course has no personal knowledge of the internal workings of the North Alaska Steamship Company in New York. The record shows that from June 2nd until June 16th. he was continually wiring insisting upon the payment of the material debts and the execution of the mortgage, and was then informed by wire from Leake, the secretary, and Rowe, the vice-president, that no money would be paid until after Mr. Mead's arrival and the examination of the accounts, and that

Mead was being sent out by the company for that purpose. Up to that time the appellant had no knowledge or information leading him to suspect dissensions and quarrels within the steamship company. The agreement between Waterhouse and King entered into on July 9th was made after Waterhouse had exhausted all efforts to get the North Alaska Steamship Company to either pay off the outstanding bills and take title and execute the mortgage, or to pay the appellant all the purchase money due him; and after the steamship company had publicly announced its inability to complete the contract, and had renounced any interest in the ship. Waterhouse then took up the matter with King for the first time, for the plain business reason that he was confronted with about $30,000 lien debts which were current bills due and payable, and which, in order to maintain his financial credit and the credit of the ship, he was compelled to immediately provide for. The idea of Dodge having a lien upon the ship never entered the minds of any of the parties to the transaction. The fact that the agreement with King was made on the same date that the steamship company abandoned its contract, simply shows that Waterhouse immediately sought relief against the outstanding bills which had been thrown upon him. The testimony of all the parties present at the transaction, and who were cognizant of the deal with King, is explicit to the point that the matter of such a contract was never hinted at

between Waterhouse and King until after the North Alaska Steamship Company had passed out of the transaction.

The appellee in the brief has stated and reiterated the ability and willingness of Dodge to have protected his debt by paying off the prior liens against the ship if he had been notified of the situation. This may or may not be true. The testimony shows that Waterhouse spent some nine days in New York endeavoring to secure payment of his own debt, or payment of the outstanding lien debts, and that he went so far as to offer to extend his own debt for six, twelve and eighteen months if the prior lien debts were paid off, and he was given a first mortgage on the ship. That being his position, it is manifest that instead of having any object in keeping Dodge in ignorance of these transactions, it was to his interest that Dodge should be notified, particularly if he had any reason to suppose that Dodge would be willing to pay off these prior debts in order to protect his own debt. This circumstance alone, aside from the other testimony, should be sufficient to show that Waterhouse was at least acting in good faith.

The testimony of Pusey shows that he was notified of the transactions taking place in New York as soon as his return to that city, and on or about the 24th or 25th of July, and he immediately thereafter conveyed the information to Dodge. At that time the "Garonne" had not

been conveyed to the Merchants & Miners Steamship Company. If Dodge was both able and willing to have taken care of these prior liens in order to protect his own debt, he could very easily have done so at that time, but he manifested no such purpose or intention. On July 27, 1904, Mr. Pusey wrote to Waterhouse stating that he had heard through Mr. King that the "Garonne" had been disposed of to a new company, but he indicated no desire to pay off the prior liens and take over the vessel even at that time, nor did he assert any lien on the vessel for this debt (see Transcript, p. 547). These facts are such as to raise a strong suspicion at least that the complainant never at any time contemplated advancing any money to pay off the liens on this ship in order to protect his claim.

The prayer of the complaint in this case is for an accounting of the money and property received by Waterhouse & Company by reason of the sale of the "Garonne," and of the value of any and all property so received, and that they be decreed to pay complainant whatever shall thereupon be found due him from the defendant, or in the alternative that the terms of the trust agreement be impressed upon said proceeds, and that the court proceed to administer the trust for the protection of the complainant (Transcript, p. 13). The testimony shows that no money whatever was ever received by the defendant from the sale of the "Garonne." The transfer to the Merchants & Miners Steamship Company was

made in consideration of stock in that company and the assumption by that company of the $67,000. The stock represented nothing, as there was no stock subscription, and the company had no assets except the ship, and the arrangement for the issuance of stock was simply to give the two parties interested an equal voice in the management of the company. No money was earned by the operation of the vessel by the Merchants & Miners Steamship Company, and when that company subsequently sold the vessel to the White Star Steamship Company it received $90,000 par value of the stock of that company in payment. There has been no attempt to show the value of that stock nor to impress any trust upon that stock in favor of the complainant. Instead the court below found that the vessel was in fact worth more than the outstanding bills and Waterhouse's debt and the complainant's debt, and therefore entered a written judgment against the defendant. This was not in accordance with the prayer of the complaint, and we respectfully submit is not according to the equities of the case, even assuming that complainant is entitled to recover. Any statement of the value of the vessel is more or less a guess. The vessel was sold on October 15, 1905, for $37,500 (Transcript, p. 233). There is no reason to assume that the Merchants & Miners Steamship Company did not sell the vessel for the best price obtainable. If the complainant was entitled to recover at all, the decree should follow the prayer by directing that an accounting be had of the property re-

ceived by the defendants from the sale of the vessel, or from its operation, and of all of the outstanding maritime liens against the vessel which the defendant had had to pay, or which have since been established, from this accounting determine whether there was a surplus applicable to the complainant's debt. The testimony shows not only the payment of the $30,000 of lien debts, but it shows the existence at the time the testimony was taken of other claims arising under the North Alaska Steamship Company's management, which were then pending and undetermined;—one of these claims, to-wit, that of C. J. Jorgenson, is now pending in this court upon an appeal by the Merchants & Miners Steamship Company from a judgment against the ship for something over $3,600. The existence of that claim was shown in the testimony in this case. Of course if that is a lien against the vessel, it was a lien paramount and prior to the claim of the complainant in this case, even assuming that complainant had an equitable mortgage upon the vessel, and is an item that would properly be taken into account in an accounting by Waterhouse & Company, as trustees.

Upon any view that can be taken, we think that this case should be reversed.

Respectfully submitted,

W. H. BOGLE,

CHAS. P. SPOONER,

Proctors for Appellant.